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**ENTREPRENEURSHIP, ENTRY AND EXIT IN CREATIVE INDUSTRIES:  
AN EXPLORATORY SURVEY**

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**ENTREPRENEURSHIP, ENTRY AND EXIT IN CREATIVE INDUSTRIES:  
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# 1. Introduction

Entrepreneurship is a frequently used catchword in industrial policy circles. Entrepreneurship is seen to promote job creation, fostering structural change and creating comparative advantages. In the tradition of Schumpeter (1912) it is argued that new innovative enterprises displace less innovative incumbents, ultimately leading to a higher degree of economic growth. Creative industries, in turn, are often considered to be one of the few economic sectors beside biotechnology with rosy potentials for growth and employment creation by policy makers in the advanced industrialized countries (e.g. EC 1998, Marcus 2005). They account roughly for 5% of GNP in most EU countries and have higher growth rates than other sectors (EC 1998).<sup>1</sup> Moreover, creative industries provide important inputs to other industries, e.g. product design or tourism.

The importance of creativity and the interaction and contrast between competition and artistic objectives provides an interesting starting point for product innovation. Interestingly, the links between creative industries and entrepreneurship is seldom made explicit, and if, then only sketchy. And indeed, there is not much knowledge about processes of entry and exit and of creative destruction in creative industries. Most studies concentrate on the part of the arts sector which are essentially non-profit in nature and considered to be fragile natural monopolies characterized by high fixed costs and a limited willingness to pay due to a limited audience. For instance, Kuan (2001 p 510) considers the performing arts as “monopolies teetering on the edge of bankruptcy.” On the other hand there are a number of competitive industries, for example the media industries or advertising, which are included in the category of creative industries.

This paper uses an industrial organization perspective. The paper is organized as follows. The next chapter provides a definition of the industries which are grouped together under the heading of cultural or creative industries. A short history of the term of cultural and creative industries is presented which shows that the creation of these terms was prevalently policy driven. An IO perspective requires a precise definition in terms of distinctive elements which separate these industries from other industries. If such a distinction cannot be established the term 'creative industries' is useless for economic policy making, as no 'sectoral' policy-making

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<sup>1</sup> Florida and Tinagli (2004) by including all "knowledge workers" conclude that creative occupations accounted for approximately 30 % of all occupations in the US, approximately 25 % in some European Countries, but only to ca. 17 % for Austria. However, Florida's and Tinagli's (2004) definition of creative work is quite inclusive.

would be possible. Section 3 provides a discussion about the interrelationships between entry, exit and entrepreneurship from an theoretical perspective. The term of innovation is adapted to the cultural and creative industries. It is argued that the literature on industrial dynamics can provide an important element in cultural economics, although no one-to-one transfer of concepts is possible. Section 4 provides a more empirical oriented discussion of possible determinants of entry and exit in creative industries by reviewing evidence from the industrial organization and entrepreneurship literatures. Concluding remarks close the paper.

## **2. The Industrial Organization of Creative Industries**

### **2.1 What industries are creative?: A brief history of the term creative industries**

The term creative industry denotes a pooling of quite heterogeneous industrial sectors. The analysis of creative industries from an economic perspective requires as its starting point the demarcation of the sector in order to associate creative activities adequately with economic activity. Creative industries are all industries along the value added chain related to cultural and artistic products and services as well as the public cultural sector. This set of industries was called originally cultural industries. The term ‘cultural industries’ was born not in academia but in economic policy circles in the UK. In the 1980’s it was used by the Greater London Council (GLC) as a polemical device to emphasize that that some cultural activities which were outside the public funding system and operated commercially were important creators of wealth and employment in order to craft a economic policy to promote and to democratize cultural production and distribution. Thus the notion of ‘cultural industries’ carried from the beginning an economic and cultural policy baggage (O’Connor 1999). This concept was adopted by other cities in the UK but also in Germany and Australia. However, for many observers the juxtaposition of ‘culture’ and ‘industry’ was seen as meaningless or contradictory (see O’Connor 1999).

The academic literature on cultural economics the focus was for a long time primarily on museums, ballet, opera, or orchestras, which are from an industrial organization perspective very similar to natural monopolies and exactly those ‘traditional’ art sectors which are heavily subsidized by the public hand and against which the original notion ‘cultural industries’ as developed by the GLC was directed. And indeed, in his survey of cultural economics Blaug (2001) identifies Baumol’s cost disease (e.g. Baumol and Bower, 1996) as the core of cultural

economics. Baumol's cost disease is the proposition that the failure of productivity increases in the arts to keep pace with productivity increases in the overall economy, while wages will rise everywhere at an approximately same rate, necessarily implies irremediable costs inflation in the arts. There is considerable discussion about whether the cost disease is myth or reality, because the cost disease thesis emphasizes the role of process innovations for economic growth at the expense of product innovations (e.g. Blaug 2001: 131). Moreover, in the Creative industries, one can observe radical technological change leading to new products and processes, e.g. the impact of the internet on the music and film industry, or the invention of book printing on book production. This shows that there is scope for disruptive technical change that changes both processes and products and leads even to the establishment of new sectors in these industries.

Cultural industries are industries whose production activities center on production of symbolic goods with strong copyright protections. This definition includes both 'traditional' arts – visual arts, theatre, music theatre, literature, museums, galleries etc. - and those 'commercial' arts termed by the GLC cultural industries – broadcast media, publishing, recorded music, architecture, new media. One can argue that contemporary art production is moving and oscillating between these two poles. Moreover, to an economist drawing a line between 'art' and 'commerce' is not analytical. Such a line is primarily an polemical device. Cowen and Tabarrok (2000) provide an interesting explanation of the observed increasing split between high and low culture (e.g. Postman 1985) in terms of increasing wealth and the pursuit of self-satisfaction of artist versus market sales. Artists derive non-pecuniary benefits when they create artworks that please their own tastes.

The Department of Culture, Media and Sport renamed the cultural industries creative industries, perhaps because of the political connotation of term cultural industries in the UK. Where this political connotation was largely absent, the term cultural industries was used to denote the same group of industries (e.g. EC 1998). In a number of countries reports about the development of the creative industries were compiled. This led to a new perception of the creative industries by policy makers. Creative industries were longer seen only through the lenses of cultural policy, but reconsidered also in terms of its economic weight for the promotion of employment and comparative advantages. Relevant research has been undertaken in the US and Europe. In Europe, one of the first reports was by the European Commission (EC 1998). Particularly relevant was the *Creative Industries Mapping Document*

by the Creative industry Task Force, commissioned by the Department for Culture, Media and Sport (DCMS) in the UK (DCMS 1998, 2001). In this document creative industries were defined in a way that takes explicitly into account the relationship between culture and economic activity. Cultural industries were defined as

*Those activities which have their origin in individual creativity, skill and talent and which have a potential for wealth and job creation through the generation and exploitation of intellectual property.*

Thus creative industries are constituted by a group of activities ranging from the arts and consumer products to electronic and digital means of communication. However, if one has a look at the studies on creative or cultural industries, one is stunned by the disagreement on the definition of creative industries (e.g. see Kulturdokumentation/Mediacult/Wifo 2004, Creativwirtschaft Austria 2004, Marcus 2005). Sometimes even the software industry is included (e.g. Florida 2002). Nevertheless, in all these mappings three different components making up the creative industries have been identified: First, economic activity directly related to the world of arts (visual arts, performing arts, literature and publishing, museums, galleries, cultural heritage etc.); second, activities related to media (press, publishing, broadcast industries and digital media); and third, design related activities (architecture, industrial design, fashion and product design). Overall, there is some tendency to consider cultural industries that is these industries that are traditionally associated with high arts as a subset of creative industries, which includes the more commercially oriented industries such as press, publishing and digital media (e.g. Marcus 2005).

The interest on the political side is matched by the academic literature, where to some degree a shift of attention from the traditional arts industries of which a number share characteristics of natural monopolies towards industries which show more competitive market structures is observed. This shift of attention towards industries which are characterized by oligopolistic or even monopolistic competitive market structures renewed the interest into the industrial organization of cultural industries. Caves (2000) provides an analysis of vertical contracts of these industries, focused primarily on the media industries. Seaman (2004) complains that most of the IO literature in Cultural Economics is concentrated on the media industries, and that there is a neglect of analysis of horizontal market interaction and competitive interaction for the more traditional cultural industries, which are usually non-profit firms and act as near

natural monopolies. One important form of competitive interaction is the entry and exit of firms.

## 2.2 Economic Characteristics of Creative Industries

One is still left with defining the common elements that make the economic analysis of these industries worthwhile. The American report *Copyright industries in the U.S. Economy* by Economists Incorporated (2002) highlights the role of intangible capital and copyright protection in those industries. They defined as copyright industries those industries where the product is reproducible and protected by copyrights. Creativity is an important input for the production of goods and services, and difficult to protect when the output is easily reproducible. In fact, a unifying feature of the creative cultural and creative industries is that originality protected by copyright is at their core. Copyrights and trademarks are the appropriate protection mechanisms for creativity in these sectors, as the respective products are primarily artistic or literary expressions, not technical ideas as such.

While some industries are prevalently competitive characterized by monopolistic and oligopolistic competition other segments of the cultural industries are dominated by non-profit firms close to natural monopolies which depend on public subsidies or even by state firms, especially cultural heritage. This suggests that creative industries can be very diverse, but that these activities share economic properties that distinguish them from other sectors of the economy (Caves 2000: 2). The basic economic properties of creative industries that make them distinctive from other industries are:

- a) Products of creative industries are typically experience goods for which tastes have to be acquired through consumption. This makes it difficult to identify demand separately from supply and vice versa (Blaug 2001, p. 127). This implies that the strong form of rational choice theory based on constant and identical preferences put forward by Stigler and Becker (1977) in their important essay 'De Gustibus Non Est Disputandum' has its limits when it comes to the consumption of 'creative' products. The products of creative industries are typically 'experience goods' for which economic agents have to acquire tastes by a temporal process of individual learning by consumption, which may lead to 'rational addiction'.

- b) Beside being experience goods which refers to the individual level, products of creative industries are often symbolic goods, whose value is derived from cultural values, that is value is constructed by imitating others or the want to distinguish oneself from others. This is clearly visible in the case of arts. The value of art is a function of social consensus, where the opinion of art world insiders has greater weight. As pointed out by Shubik (2003, p. 195), “unlike the evaluation of many consumer goods, the problem in the evaluation of the worth of an art object is by far more dependent on cultural norms and social acceptance than the perceived needs of the consumers.” In fact, when culture is seen as "a signifying system through which [...] a social order is communicated, reproduced, experienced and explored" (Hesmondalgh, 2002: 11) then the primary activity of cultural activities is to generate and communicate symbolic meaning. This suggest that products of creative industries have often a positional character, and consumption patterns depend on interdependent preferences. In the economics literature there is now a rich literature on the adoption of positional goods, such as fine art, holiday resorts, luxury cars or fashion goods (e.g. Pesendorfer 1995, Swann 2001 or Reinstaller and Sanditov 2005). Some Authors emphasize that if the behavioral patterns of an individual are enforced or dampened by the behavior of peer groups, chaotic demand patterns may emerge (Congleton 1989, Iannaccone 1989 or Cowan, Cowan and Swann 1989).
- c) Due to the to elements products of creative industries differ unpredictably in the quality levels that consumers see in them. This induces a great uncertainty about how consumers will value a new creative product. This is amplified when the creative good is a complex product, where costs are high and to a large extent sunk, e.g. in the film industry (DeVaney 2003). Although creative products are experience goods, the buyer’s satisfaction will be a subjective reaction. Even substantial knowledge about the production process does not reduce the fundamental uncertainty of demand (DeVaney 2003). This uncertainty is associated with a short period of profitability.
- d) Creative industries are typically characterized by a high level of product differentiation. The products sold are differentiated, for example, no art work is like another. Some of the products are reproducible, others not. The high degree of product differentiation is linked to the symbolic and positional content of many cultural products and to the fact that cultural products contain some aspect of novelty, that is product innovation. In many sectors entry is unrestricted. This leads to trade-off between efficiency and diversity. The



economics literature shows that there could be easily either too much variety or not enough (e.g. Dixit and Stiglitz 1977).

- e) Most creative products are durable, in the sense that they can be used repeatedly. In fact, most products of creative industries beside having a symbolic meaning, embody, at least potentially some form of intellectual property (Thorsby 2001). In fact the expansion of the concept of creative industries towards the concept of creative industries does not only emphasize the artistic component but also the reliance on intellectual property (e.g. Caves 2000, UNCTAD 2005). The central issue in the economics of copyrights is the same as in patents: balancing appropriability and accessibility, that is regulating incentives and distortions of supply. This leads to the trade-off between 'productive' and 'reproductive' fair use (Landes and Posner, 1989). If copyrights are too strong, they increase the (transaction) costs of creation; if they are too weak, the reduced value of copyrights decreases the incentives to create. Technological development such as digitalization created new hardware and techniques for reproducing and copying creative work. This led to the strengthening of copyrights in the US and in Europe following the WIPO (World Intellectual Property Organization) treaties on copyright and performance and phonograms. These treaties addressed also the digital network environment which figures prominently in the policy discussions on creative industries (e.g. Marcus 2005). In fact, copyright law can have far-reaching effects on markets in the cultural industries, including the encouragement or discouragement of competition through entry barriers. A number of commentators have argued that there is no economic justification for a further strengthening of copyrights, as there is only cursory evidence that stronger and longer copyright protection increases the provision of creative work. In addition, there is even less evidence available to assess possible welfare effects thereof (Towse, 2005).<sup>2</sup>
- f) Some industries are characterized by a specificity of technological development. Blaug (2001: 131) described Baumol's concept of the cost disease as the "jewel in the crown of cultural economics". The proposition is that the failure of technical progress in the arts to keep pace with technical progress in the economy as a whole, while wages nevertheless rise at the same rate, implies irremediable cost inflation in the cultural industries. The

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<sup>2</sup>) An empirical study on the effect of the Sonny Bono Act in the USA, which extended the term of copyrights on the author's life plus 70 years on the movie industry concluded that it appears „to have been a giveaway to owners of existing creative work, while having relatively little impact on new creative activity“ (Hui and Png, 2002, p. 219). For an extreme position against IPRs see Boldrin and Levine (2002, 2004).

same proposition holds also for other service industries that are labor intensive. However, there is considerable controversy about whether this proposition is realized. An implication of the cost disease is that the composition of spending has to change as larger proportions of income have to be spent on labor-intensive services. The cost disease is often used as argument that the arts need to be subsidized if they are to survive. However, if the composition of spending changes due to Engel's law with changes in income this conclusion is not warranted (Blaug 2001).

- g) It is often argued that the art has positive external effects and characteristics close to public goods, therefore public subsidies for the arts are warranted. This argumentation is stronger for the cultural industries that are composed of non-profit firms (or state owned firms in Europe) that are characterized by near natural monopolies than for competitive media industries. However, a large number of European countries have public subsidy programs for most creative industries, except perhaps those where only for-profit firms compete with each other. In fact, there are a number of studies that show that people are willing to subsidize arts even if they themselves do not consume art performances (e.g. Thosby and Withers 1985, West 1989). There is almost an universal consensus among economists in favor of public subsidies for the arts (Blaug 2001). Only some lonely voices argue that the cultural industries should be ruled by the market (e.g. Cowen 1998). However, there is substantial disagreement about the best ways of subsidizing what. There is a own literature on the rent-seeking activities by art lobbies which may result in excessive subsidies to the arts (e.g. Frey and Pommerehne 1989).<sup>3</sup>

Some of these properties are more prominent in one industry, others in other industries. For example, while the art galleries constitute a quite competitive industry and do not show signs of a cost disease, opera houses operate in a near natural regional monopoly situation due to the high fixed costs associated with staging opera productions. The different industries making up creative or cultural industries are characterized by quite specific economic problems that govern both the horizontal and vertical industrial organization of these industries. Caves (2000) provides an important analysis of the vertical industrial organization in creative industries from the point of view of optimal contract theory. The next part we concentrate on entrepreneurship, entry and exit.

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<sup>3</sup>While these considerations are especially important for the 'high' art, in an interesting contribution Romer (2002) argues that the two standard textbook answers that the government should provide public goods and the private sector should provide private goods completely misses the crucial importance of non-rival goods for modern economies.

### **3. Entrepreneurship, innovation and competition in creative industries**

The role of business dynamics, that is the entry and exit of firms, in economic development was first studied in a systematic way by Schumpeter (1912). According to Schumpeter's theory of creative destruction, growth, innovation and business cycles are inherently connected and the economy develops through a process of variety generation (innovation) and selection (competition). Firms gain competitive advantages through innovation and by doing so they achieve excess profits, which encourages imitation. Formalized variants of Schumpeterian competition figure prominently in the new growth theories (e.g. Aghion and Howitt 1998, Nelson and Winter 1982). Schumpeterian competition emphasizes the entry and exit of firms and the contribution of technical change and research and development to economic growth. Large part of this literature is concerned with innovations stemming from research and development, thus with technical innovation. Florida (2002) claims in his controversial account about the rise of the 'creative economy' that in this part of the economy the spheres of innovation, business and culture are drawn into another, resulting in more powerful combinations.

However, while technical innovation is central to creative industries, here the impulses come primarily from external research and development in other sectors. The innovation process in the creative industries is mostly non-technical, as these industries are typically service industries (e.g. digital content) and labor-intensive industries (e.g. theatres). This is also reflected by the fact that patents do not play an important role in creative industries. Copyrights and trademarks are the appropriate protection mechanisms for creativity in these sectors, as the respective products are primarily artistic or literary expressions, not technical ideas as such.

The importance of non-technical innovation has increased in recent times. Non-technical innovation encompasses organizational innovation (e.g. particular forms of organization in purchasing, knowledge management, production preparation, production, distribution, etc.; new forms of cooperation between companies, benchmarking) and product innovation that is not related to technical characteristics of the product. For the creative industries, of course, both technical and non-technical innovation are important.

The process of creating new products in the creative industries is often embedded in networks and clusters. Due to the relatively small size of the firms there is often a necessity to cooperate, and in some industries project-oriented structures are dominant (e.g. in the movie production in non-Hollywood firms). Knowledge-sharing is an important feature, as is the cumulateness of the process of creativity.

From a bird's eye perspective the Schumpeterian model certainly fits creative industries, as technical change revolutionized and revolutionizes creative industries. For example, taking an example from the prehistory of creative industries, the book industry benefited enormously from the invention of the printed press. This made it easy and cheap to reproduce books, which in turn changed consumption patterns. The invention of recording music allowed music fans to 'buy' the best musicians and hear high-quality music on disc, rather than hearing a live singer at some local concert. Those innovations not only change market structures or business methods, they are instrumental in creating new industries. However, the creative process leading to new products in the industry is substantially different from the technological and organizational change where improvements in productivity are a central element of the innovation process. In contrast to technological innovations such as book printing, which made the manual copying of books obsolete, there is no obsolescence of the very products of creative industries. For example, plays by Shakespeare or Goethe, paintings by Klimt or Rembrandt or records by Jimi Hendrix do not become obsolete because of new books by Stephen King, new paintings by Gilbert and George or new records by the Foo Fighters. Thus, there is a fundamental difference between technological and organizational innovation usually considered in the economics of technological change and artistic innovation.

This suggests that the Schumpeterian model of economic growth is only appropriate for technological and organizational innovations. The model of increasing variety by Romer (1990) or the model of sectoral evolution by Saviotti and Pyka (2004) with unbalanced growth at the industry level seem better to fit the experience of the creative industries.

Overall, entrepreneurship has become more important in the modern economies. While Florida (2002) talks about the creative economy, Audretsch and Thurik (2001) talk of the entrepreneurial economy. Audretsch and Thurik (2001) have observed a reversal of the trend towards large enterprises towards small and medium sized industries. They developed a

explanation of the reemergence of entrepreneurship in Europe and North America based on increased globalization, which has shifted the comparative advantage towards knowledge-based economic activity. With knowledge as important factor of production, knowledge spillovers have also become more important as a source of economic growth (Romer 1986). Audretsch and Thurik (2001) argue that entrepreneurship is important in a knowledge economy because it provides a key mechanism by which knowledge created on one organization can be commercialized in a new enterprise. Small firms are no longer seen to be primarily as small firms. Jovanovic (2001) argues that entrepreneurial experimentation is more important in the new economy where technologies and products become obsolete at a much faster rate than before and that therefore "it is clear that we are entering the era of the young firm. The small firm will thus resume a role that, in its importance, is greater than it has been at any time in the last seventy years or so" (Jovanovic 2001: 55). The flow of entry and exit of new firms represents a changing pool of competitors. Beesley and Hamilton (1984) describe entry and exit dynamics as seedbed for new activities from which successful new firms and industries emerge. Therefore the process of entry and exit of firms serves as an important source of structural change in industries.

Despite the popularity of the Schumpeterian concept of entrepreneurship of starting a new enterprise as the defining entrepreneurial activity, there is no generally accepted definition of entrepreneurship (OECD 1998). This failure of a single dimensioned definition of entrepreneurship shows that entrepreneurship is essentially a multidimensional concept (Peneder 2005). This is also reflected on the empirical level. Empirical research on entrepreneurship is variegated. This is directly related that the concept of entrepreneurship is difficult to operationalize for empirical measurement (e.g. Storey 1991, Peneder 2005). The different contexts and organizational forms involving entrepreneurship account for paucity of measures used to operationalize entrepreneurship. A number of studies have deployed a variety of proxy measures spanning from business ownership rates, self-employment rates, new firm startups (e.g. Reynolds et al. 2000), patents (e.g. Audretsch 1995) as well as measures of firm demography such as the turnover and volatility of firms (e.g. van Stel and Diephuis 2004). This makes clear that while entrepreneurship is a heterogeneous activity encompassing a broad spectrum of activities, e.g. setting up a new business, an innovation, introducing a new product into the market, many of the measures reflect entrepreneurship as a quite homogenous activity. Entrepreneurship is shaped by many factors, spanning a spectrum of determinants, ranging from economic to social, cultural and political ones. It is useful to

make the distinction between factors shaping the supply of entrepreneurship and those influencing the demand for entrepreneurship. The demand for entrepreneurship reflects the opportunities to engage in entrepreneurial activity. This is related to incentives and barriers to entrepreneurship at the industry and the national level. The opportunity for individuals and firms to engage in entrepreneurial activity is shaped by industry characteristics, characteristics of the individual entrepreneur and his firm, and by regional aspects. The supply of entrepreneurship is shaped by the characteristics of the population of potential entrepreneurs, their human capitals and their attitudes towards entrepreneurship.

Returning to the creative industries, one can observe that not all industries in the framework of the creative industries are populated by small entrepreneurial firms and individuals. Some industries are dominated by oligopolies of large firms, e.g. recorded music and movies industries, while others are close to natural monopolies, e.g. opera houses or cable TV. However, a large part of creative industries is populated by small firms (and large firms) and characterized by competitive interaction, e.g. books, magazines or the performing arts.

#### **4. Determinants of Entry and Exit in Creative Industries**

The literature on entry and exit shows that entry and exit rates vary quite strongly across industries (e.g. Dunne et al. 1988, Siegfried and Evans 1994., Geroski 1995, Fotopoulos and Spence 1998, Carree and Thurik 1999, Hölzl and Sögner 2004). Most studies on the manufacturing industries emphasize barriers and incentives that influence the sectoral demand for entrepreneurship. For some of the industries environmental characteristics related to cost and demand specificities may restrict the turnover of firms and entrepreneurial ventures for the entire lifespan of industries. As the entry and exit of firms is closely related to entrepreneurship (Audretsch and Thurik 2001), we consider the determinants of entry and exits and the specificities of creative industries in some detail. We will discuss here three kinds of possible determinants that are worth to be studied. First, we consider the supply of entrepreneurship which is closely related to questions of the labor market in creative industries. It is well known that the labor market in creative industries has quite special features. After this we consider determinants of entry and exit from an industrial organization perspective, thus from the perspective of demand for entrepreneurial services. The literature

on entry and exit in manufacturing industries emphasizes the importance of demand and specificities of cost functions. Third we consider possible macroeconomic determinants of entry and exit.

#### 4.1 The artist's labor market and the entrepreneurship literature

The labor market for potential entrepreneurs into creative industries is different from other potential entrants into other industries. McCarthy et al. (2001) and Throsby (2001) claim that creative labor markets have several characteristics which make it distinct from other labor markets. There are clear specificities in the careers of artists that make careers different from careers in other sectors: the degree of uncertainty in the arts is higher than in most other careers, consequently earnings tend to peak early and to decline quickly. Most artists leave their careers in the mid-thirties due to limited career opportunities. Employment is often sporadic and fragmented and there the industry contains a predominance of part-time workers and multiple job-holders (Throsby 2001). Many of the performing artists, directors, or visual artists and others can be considered as self-employed freelancers. In this context multiple job-holding is a common formula to derive income. The motives for the choice of this career track are strongly non-pecuniary. Artists often live off wealth to finance their artistic career. Only a few become superstars. Consequently there are considerable differences in income distribution and incomes are highly skewed. However, the potential of great success provides critical inspiration.

A number of empirical studies show that artist's labor markets are special in being invariably part-time and little influenced by years of schooling (e.g. Throsby 1992, Towse 1996). Moreover, there is ample evidence that human capital variables in earning functions are not that important as compared to other occupations, leading to the claim that the "human capital model does not apply to the arts" (Towse 1996: 308). Although specific training increases art-related income and general education increases non-arts earnings, the evidence shows that formal education and training provide a small (or even negative) contribution to employment and earning potentials for artists (e.g. Wallsall and Alper 1992, Townse 1996, Throsby 1996, Karhunen 1996). A number of studies show that 'learning-on-the-job' plays a more important role than formal training.

The importance of non-pecuniary benefits ("art-as-a-way-of-life") has the consequence that despite the low level of wages for the large majority in the cultural and creative industries, there is generally an oversupply of labor. For most, the non-monetary reward of being an artist represents an important argument. These empirical stylized facts are reflected also in more formal economic theorizing. For example Cowen and Tabarrok (2000) make the plausible assumption that there is a discrepancy between the utility derived by artists depends on their own tastes. The less closely the activity is related to the core of the 'art' industries the less important these feature will be.

In each case the individual is an important unit of observation for analyzing the determinant of entrepreneurship. Within the economics literature, the model of income choice is the most important theoretical framework. In its most basic form, individuals are confronted with a choice to earn income either through wages in existing firms or through profits from their newly started firms. The choice of income is made by comparing the wage individuals expect to earn through employment with the profits that are expected from entrepreneurial action. Khilstrom and Laffont (1979) have been expanded to incorporate risk. Most empirical tests of the model have focused on personal characteristics with respect to labor market conditions. For example, Blanchflower and Meyer (1994) emphasize human capital in the income choice. In the light of the previous discussion on the specificities of the labor market for artists, this model has some serious limitations, as artists do receive utility from making art, so that they end up living off wealth to be an 'entrepreneurial artist'

As labor markets for artists are quite different from labor markets for plumbers, we do expect that the model of income choice needs to be expanded in order to account for the utility maximizing behavior of potential artist. To drive the point home consider the artist utility function used by Cowen and Tabbarok (2000):

$$U_A(c, L, s) = U(c) + V(L, s) \tag{1}$$

where  $U_A(c, L, s)$  is utility function of an artist. It is additively separable in consumption and art production,  $U(c)$  is the utility derived from consumption of goods other than art and art production and  $V(L, s)$  is the utility of working  $L$  units on time on art of satisfaction level  $s$ . The artist then maximizes  $U_A(c, L, s)$  subject to the budget constraint:



$$c = w_A(s) L + w(I-L) + y \quad (2)$$

where  $w_A(s) L$  is income from the art sector with wage  $w_A$ ,  $w(I-L)$  is the income from the non-art sector with wage  $w$ , and  $y$  is wealth or some non-wage income. The trade-off between pecuniary and non-pecuniary benefits results in the fact that artists do not generally maximize profits. As the utility on working on art increases with the level of satisfaction  $s$ . In equilibrium  $s$  will be generally higher than the market demands (Cowen and Tabbarok 2000: 236). Artists like to shift the production of art from production for market sales toward production in pursuit of artist satisfaction. An implication is that the model of income choice needs to be expanded to take into account the non-pecuniary benefits to creative workers. Given this utility function, one is led to speculate on an abundance of supply in the labor market for cultural industries, which in turn leads to strong selection pressures. However, as the budget constraint (2) shows in extreme cases the income from arts could even be negative provided that  $w(I-L) + y$  is substantially larger than  $w_A(s) L$ . This allows artists to reallocate time to genuinely artistic activities.<sup>4</sup> In fact several researchers have endeavored to separate 'arts-related' earnings from 'non-art-related' earnings (e.g. Thorsby and Thompson 1994). And in fact, general education exerts a strong positive effect on 'non-art-related' earnings (Thorsby 1996).

To summarize, the labor market characteristics for artistic work are quite special as regards standard results for other industries. This leads to chronic excess supply, part-time and multiple job holdings (Wassall and Alper 1992, Thorsby 1996, Towse 1996). This has strong impact on the research on the supply of entrepreneurship, especially for those segments of the creative industries which are closest to the arts and for those where self-employment ratios are high.

#### 4.2 Barriers and incentives to entry and exit: the industrial organization literature

The dynamics of entry and exit are quite well explored for manufacturing industries. Most of the empirical work concerns entry. Siegfried and Evans (1994) have classified in their literature survey over 70 different empirical studies on entry and exit. They distinguish between incentives and barriers. Table 1 presents the gist of their findings in short. The last

column shows the robustness of the signs associated with incentives and barriers. Table 1 shows that for a number of variables that no conclusive evidence can be assigned on the basis of the results from the 70 studies.

**Table 1 : Classification of determinants for entry and exit**

Entry	Incentives	Expected profits		+	
		demand growth		+/~	
	Barriers	structural barriers	cost differences		-
			economies of scale		~
			multi-plant economies		-
		behavioral barriers	limit pricing		~
			excess capacity		~
	Incentives or Barriers	product differentiation		~	
		R&D and innovation		~	
	Exit	Incentives	low profits		+
decline of demand				+	
Barriers		sunk costs		-	
		intangible resources	quality of management		-
			diversification		-
Interaction between entry and exit				+	

Notes: based on Siegfried and Evans (1994) and Caves (1998); +,-,~ indicates a robust positive negative or a not robust association

Let us consider the determinants in more detail. The inter-industry analysis of entry and exit has relied on the specification of the entry regression by Orr (1974). The precise specification has varied, the basic model of entry or exit (Shapiro and Khemani 1987) is characterized by:

$$Entry/Exit = f(Barriers\ to\ Entry/Exit; Incentives; Interaction\ Entry/Exit; Controls) \quad (3)$$

where entry (exit) are measured typically as the number of entry (exit) or the entry (exit) rate. Barriers to entry/Exit is a vector and usually represented by largely time-invariant vectors of structural characteristics of the industry (e.g. minimum efficient scale, advertising, R&D, capital intensity, sunk costs etc.) that are considered to deter entry or exit. The literature on entry barriers emphasizes that there are market conditions that allow incumbents to raise prices above costs persistently without attracting entry. The distinctive element of entry barriers is that they create an asymmetry between incumbents and potential new entrants. Barriers to entry are rents derived from incumbency which impose an entry cost to entrants, which incumbents do not have to pay (Gilbert, 1989). Exit barriers in turn make it more

difficult for incumbents to exit the markets (e.g. sunk costs). A number of contributions (e.g. Caves and Porter, 1976; Eaton and Lipsey, 1980) have claimed that barriers to exit are related to barriers to entry, that is they create mobility barriers. The basic idea behind this claim is that exit barriers increase the costs of exit and thereby create thereby a zone of inaction where entrants are less likely to enter and incumbents less likely to exit. This suggests that a simple distinction between entry and exit barriers is not easily possible. However, this type of modeling has also drawbacks. Caves (1998) points out that the inclusion of concentration variables and price cost margins as separate regressors runs the risk of adding redundancy if one accepts the view proposed by the Structure-Conduct-Performance paradigm where structural characteristics constrain the number of firms in the market and lead to an equilibrium characterized by concentration. Structural and strategic entry barriers may also introduce a difficulty, insofar as they are different in one specific characteristic. Strategic entry barriers are essentially an ex-ante phenomenon, while structural entry barriers are both ex-ante and ex-post phenomena (Roberts and Thompson, 2003).

The incentives vector captures changing market conditions that create opportunities for new entrants. Two typical variables are profits and industry growth. While the effect of the latter is not unambiguously to foster entry and to reduce exit, the sign of profits (usually measured) as price-cost margins is more ambiguous (e.g. Kessides 1990, Caves 1998, Roberts and Thompson 2003, Hölzl 2005), as the defense of high rents gives incumbents an incentive for ex-post retaliation. Knowledge, about this could lead to a situation where high profits do not lead to new entry. On the other hand low profits do in fact increase the likelihood of exit (Shapiro and Khemani 1987).

The interaction entry/exit refers to the intertemporal relationship between entry and exit. Carree and Thurik (1996) and Roberts and Thompson (2003) provide a study of the interaction between entry and exit which can encompass a number of cases: (i) displacement, where the entry of firms leads to the exit of firms, (ii) replacement, where the exit of a firm opens room for the entry of new firms, (iii) demonstration, where entry leads to more entry via a demonstration effect, (iv) shakeout, where wave of entry is followed by a wave of exit, this leads to a revolving door hypothesis, where the simultaneous entry of firms leads to the subsequent exit of the same firms. This latter mechanism is also defined as entry into and exit from the competitive fringe of small firms. The empirical literature has shown that the close correlation between entry and exit is a stylized fact across most industries (Geroski 1995), but

the causation may not be unidirectional and be industry-specific. Carree and Thurik (1996) find evidence for displacement and replacement processes for the retailing industries in the Netherlands, as do Fotopoulos and Spence (1998) for Greek manufacturing industries and Roberts and Thompson (2003) for Polish manufacturing industries. The Controls are usually industry size, to accommodate differences in the number of firms in the industry.

Beside industry characteristics also variables related to firm-specific characteristics can be included. This is usually done in order to study the post-entry performance of new firms (e.g. Mata and Portugal 1994, Audretsch and Mhamood 1995, Audretsch, Santarelli and Vivarelli 1999). These studies have suggested that there is a positive relationship between plant size and survival (e.g. Audretsch and Mahmood (1995), Disney *et al* (2000)). The main explanation put forward for this relationship relates to the view that larger firms are more likely to have levels of output close to the minimum efficient scale (MES), *ceteris paribus*, and thus smaller firms have an inherent size disadvantage. While these studies generally find a positive relationship between size of entry and survival, Wagner (1994) finds no such relationship for German manufacturing. Wagner, arguing along the lines of Geroski (1991), suggests that local conditions in particular market niches are more likely to be important to small entrants and thus suggests that there may well be no significant relationship between concentration and survival. The performance of new firms is also conditional upon location. Fotopoulos and Louri (2000) show that location in the Greater Athens area increase the likelihood of survival. Colombo and Grilli (2005) show for a sample of Italian high-tech firms, that those firms that obtain external private equity have higher start-up size and therefore higher survival rates, than new entrants that are debt-financed or firms that are financed through founders personal savings.

Turning back to the creative industries, it is easily to note that specific analyses of entry and exit for the creative industries are not frequent. While there are some studies on the specific industries (e.g. Berry and Waldfogel (1999) on the entry and exit of radio broadcasting firms) no cross-section or panel study on entry and exit in creative industries does exist. However, as Carree and Thurik (1996) note, it is also difficult to have entry studies for the service industries, as the data for service industries are not readily available. They emphasize that some of the determinants which are frequently studied for the manufacturing industries, are not readily available for service industries. In the creative industries the specificities of the vertical organization of the industries are quite important in providing incentives and barriers to entry (e.g. Caves 2000). However, an cross-industry study would be interesting in order to classify the sub-groups of creative industries. Geroski (1995) emphasizes that the only

industry-specific characteristic that was consistently related to entry was industry growth, which opens up new room for entrepreneurship. However, the number of entry is probably related to market size. The organizational ecology literature, points at a causal relationship between the number of firms and entry rates. Competition leads then to higher exit rates. A number of studies have shown that industry size matters for both entry and exit processes (Carroll and Hannan 1995, Ilmakunnas and Topi 1999). Market size is most probably determined by the minimum efficient size of entrepreneurial ventures in the industry, which in turn is related to production cost function of the activity and its transaction costs. Carree and Thurik (1999) call this the carrying capacity of the market.

Each of the industries in the creative industries has its own specificity. In most of the creative industries firm size is very small (e.g. Kulturdokumentation/Mediacult/WIFO 2004), markets are usually segmented. An important contribution would be to engage in a classification exercise and to classify the industries making up the creative (cultural industries) according to industry-specific characteristics. Peneder (2003) provides an excellent survey of scope and methods of industry classification.

Let us now turn to some more specific questions of entry and exit. There is now a substantial literature on industrial dynamics and industrial life cycles. This literature is usually centered on manufacturing industries. It would be interesting to know whether creative industries do fit the model of the industrial life-cycle or not. And if not, what characteristics do explain non-industrial life cycle patterns? Another important question regards the issues of intellectual property rights and public subsidies. We provide a short discussion of these three issues in turn.

### *Industrial dynamics and industrial life cycles*

According to theory of industrial life cycles (e.g. Gort and Klepper 1982, Klepper 1996, Agarwal and Gort 1996) entry and exit in manufacturing industries are determined by stage-related changes in competition intensity. With more intense competition only the more efficient firms survive. The intensification of competition leads to more stringent entry barriers, more exits and less entries. This is the industry-life cycle view on industrial competition. Gort and Klepper (1982) tried to understand the long-term evolution of

innovative industries, and assessed that this long-term evolution is essentially characterized by a life cycle in which industries arise in their birth time, grow and mature in their development time, and decline in their death time. The industry life cycle clearly added value to the explanation of a large number of regularities occurring in innovative industries. The shakeout, which corresponds to a massive exit of producers, progressively became a central regularity to be explored in industrial dynamics. While entries are concentrated in the beginning of the industry-life cycle, an exit wave is associated with the maturity of the industry. Abernathy and Utterback (1978) and Utterback and Suarez (1993) developed an analysis of shakeout which is derived from the traditional Schumpeterian hypothesis on the R&D advantage of large firms. Jovanovic and Mc Donald (1994) propose a vision of the shakeout based on a technological shock, exogenous to the industry. Klepper (1996) relates the shakeout to the timing of entry. However, while many industries evolve according to the industry life cycle principles, there are a number of industries, that do not fit the story of the industry life cycle, Krafft (2004) emphasizes that some high-technology industries do not conform to the industry life cycle framework, either because they are essentially knowledge-driven instead of technology-driven, and because they exhibit non-shakeout patterns of evolution. The reason for this in knowledge-driven industries is found in the crucial role of networks, clusters, alliances and co-operations. In fact, one might argue that a number of service industries do not conform industry-life cycles, and there is no real evidence for creative industries to follow industry life-cycle patterns, either because they share some near natural monopoly characteristics or because of the organization of knowledge in the industry. It would be interesting to know whether the more oligopolistic industries such as the movie or the music industries do confirm the patterns of the industrial life cycle hypothesis.

#### *Intellectual property rights as incentives or barriers to entry*

The recognition that intellectual property (IP) rights have a major influence on innovation and creativity has driven the recent strengthening of IP protection and enforcement. However, in recent times economists and other researchers have questioned the economic rationale for strong IP protection (e.g. Boldrin and Levine 2002, 2004). The primary economic rationale for intellectual property is that it encourages the development of new products and processes, thereby increasing social welfare. While it is common knowledge that strong property rights for rival goods are conducive to economic growth, for non-rival goods such as ideas, the economic rationale is less clear. For non-rival goods, property rights involve the trade-off

between incentives (appropriability) and monopoly distortions (Landes and Posner 1989, Romer 2002, Scotchmer 2004, Towse 2005). There is some controversy about the question whether intellectual property rights work primarily as incentive mechanism or whether they can also constitute barriers to entry and being counterproductive for innovation.

The relationship between the strength of copyrights and welfare is probably non-linear. A very low protection would discourage creative work, to strong protection could have negative effects on market structure, increasing barriers to entry and to innovation due to rent-seeking behavior (Boldrin and Levine 2004). An example is the music and movie industry, where a number of observers think that extension of the copyright duration has nothing to do with protecting the creativity of artist but is due to the pressures of a powerful and well organized pressure group (Boldrin and Levine 2004). In fact the evidence by Hui and Png (2002) suggests that the copyright reform seems to have "been a giveaway to owners of existing creative work, while having relatively little impact on new creative activity"(Hui and Png, 2002, p. 219). Towse (2005) provides a critical discussion of the extension of copyright protection for the creative industries and concludes that the unintended consequences of extending and strengthening copyright protection are not taken in consideration. One consequence is to increase the value of existing copyright assets which increases entry barriers into creative work, e.g. if creative work is cumulative or rights are held in monopolistic industries. This might lead to increased incentives to oligopolization and monopolization, with its negative effects on variety (Alexander 1994).

This story is likely to be similar to the controversy about software patents, where more evidence is available. The controversy about software patents (strong IPR for software instead of the weaker protection through copyrights) stems from three interrelated issues, which are to some extent similar to the creative industries. First, software is the prototype of a cumulative technology, where incremental innovation is prevalent. The same largely holds true for the arts. Second, open source plays an important role in software development. This is also the case to some extent in creative industries, where collaboration is widespread and creativity is amplified by the creativity of others. Third, software is pervasive, thus is also of central interest to the creative industries. This shows that there are fundamental questions regarding the optimal design of software protection is open. From an economics point of view, the cumulative character of the software development process raises the question whether software requires different rules than standard patenting in order to provide true incentives for

innovation that allows follow-up invention. Theoretical research shows that in cumulative settings strong IPRs such as patents may be counterproductive (Scotchmer 2005, Bessen and Maskin, 2004) and induce wasteful rent-seeking behavior (e.g. Boldrin and Levine, 2004). This negative effect is mirrored by the evaluation of software patents in the US. The introduction of software patents in the US was characterized by low patentability requirements (OECD, 2004). The empirical evidence provided by Bessen and Hunt (2003) indicates that software patents increased from fewer than 5,000 patents a year to 20,000 patents in 2000. This is approximately 15 % of all patents granted in the US. Interestingly, only a small fraction of software patents is owned by software publishers, while the vast majority of patents are held by large firms in the ICT, electronics, and machinery industries. Moreover, compared to other technological fields, a larger share of patents is held by large firms (Bessen and Hunt 2003). The main issue is whether software patents stifle innovation and facilitate anti-competitive behavior. Bessen and Hunt (2003) found that the surge in software patenting is primarily related to a sizeable rise in the cost effectiveness of software patents. They found a significant negative relationship between software patents and R&D intensity. This result is difficult to reconcile with the incentive theory of IPRs.

#### *Public subsidies as barriers to entry?*

The public sector plays an important role for the creative industries. Some of the cultural industries could not survive without public financing. This is associated with the fact that many cultural products have public goods characteristics or are meritocratic goods. For those industries that have a near natural monopoly characteristic barriers to entry exist simply because of the cost structure. In these cases entry barriers may actually increase social welfare. However, in other industries some specialization due to public subsidies and public contracting did emerge. For example the study of the Viennese creative industries (Kulturdokumentation/Medacult/Wifo 2004) has shown that small enterprises have difficulties in obtaining public contracts. Some commentators suggested that public subsidies do lead to the formation of art lobbies whose rent-seeking activities do discourage innovation and entry. The central element of public subsidies for the arts is primarily studied from a normative perspective, however in terms of effect on entrepreneurship the positive consequences of public subsidies for the arts are central.



### **4.3 Macroeconomic determinants of entrepreneurship**

Whether entry and exit rates vary over the business cycle is subject to considerable debate and the evidence is quite inconclusive. A number of industry studies find only weak influences of the business cycle on entry and exit. For example, Campbell (1998) found that entry rates are weakly (and statistically insignificantly) pro-cyclical. Exit rates, in contrast, are counter-cyclical. Campbell (1998) explains this on the basis of a vintage capital model. In a similar vein, Caballero and Hammour (1994) suggest that a recession (aggregate fall in demand) will push the most inefficient firms out of the market. According to Caves (1998) the stage of the business cycle is likely to exert an important influence on the entry and exit processes.

On the basis of the entrepreneurship literature the question has been investigated whether unemployment increases or reduces the propensity to set up a new firm. For example, Foti and Vivarelli (1994) find that aggregate unemployment has a positive impact on entry into self-employment in Italy. This is related to a “recession push” scenario, which implies higher gross entry and gross exit in economic downturns. The plausibility of this scenario is related to the observation that during phases of increasing cyclical unemployment, individuals are “pushed” into an entrepreneurial role (e.g. Storey 1991, Pfeiffer and Reize 2000). The standard argument to start-up a business from unemployment is that the opportunity cost of self-employment declines when becoming unemployed. Sögner (2005) finds that entry rates growth rates significantly depend on the growth rates of the real gross domestic product and unemployment.

In contrast, Ritsila and Tervo (2002) have found no influence of the national unemployment rate on new firm formation in Finland, however they find a positive relationship between individual unemployment and self-employment. Fotopoulos and Spence (1997) argued that nearly every conceivable outcome in terms of the sign can be expected at the industry level, depending also on the specificities of the industries. Those industries, where setting up a new business is comparably cheap (self-employment) are much more likely to experience a recession-push than industries with high entry barriers. For the latter industries one would expect a "expansion-pull" scenario.

As creative industries are quite variegated, it would be interesting to know, whether some of the industries experience a recession-push or a expansion-push. However, we expect that the specificities of labor markets for creative industries, described in section 4.1 are relevant for the effect of macroeconomic variables on the entry into and the exit from creative industries.

## **5. Concluding remarks**

This paper presents an exploratory survey on entrepreneurship, entry and exit in creative (cultural) industries. While the definition of creative (cultural) industries is not entirely straightforward, these industries share a number of specific characteristics that make them similar and worth of economic analysis, even if there is quite some heterogeneity across these industries. Exactly this heterogeneity provides opportunities to study entrepreneurship in different settings, especially as regards the classification of the industries making up the creative and cultural industries.

The specificities of the creative industries include the centrality of considerations of intellectual property rights on the incentives to set up firms and considerations related to the public sector interaction through subsidies. However, the most important difference between creative and manufacturing industries is found in the labor market for the creative industries, which values training on the job much more than formal education. Given the attention policy makers direct towards the creative industries, the study of entrepreneurship, entry and exit and its determinants from an industrial organization perspective is needed.

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